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No. 84-2006

IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

DON C. JOHNSON and ELIZABETH A. JOHNSON,
Petitioners,

v.

MILTON RIGHETTI, GLORIA RIGHETTI,
MILTON E. RIGHETTI, MICHAEL RIGHETTI,
MARILYN RIGHETTI, and MARY ANN RIGHETTI,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTION PRESENTED FOR REVIEW

1. Whether an award of attorney's fees against secured Creditors (the Righettis), pursuant to California Civil Code Section 1717, is proper after an unsuccessful attempt by such Creditors to obtain Relief From the Automatic Stay pursuant to U.S.C. 362(d)(1).

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RESPONDENTS' BRIEF IN OPPOSITION

The Respondents, Milton R. Righetti, et al., respectfully oppose Petitioners' prayer that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered on March 28, 1985.

STATUTORY PROVISIONS INVOLVED

Respondents respectfully refer this Court to the Petitioners' statutory provisions.

STATEMENT OF THE CASE

The facts underlying this appeal are relatively straightforward. On June 17, 1977, Dr. and Mrs. Don C. Johnson (Debtors) purchased a parcel of land owned by Milton R. Righetti and his family (Creditors). In order to facilitate the transaction, the Creditors took back a Promissory Note, secured by a Deed of Trust on the land.

Thereafter, on November 12, 1982, the Debtors, having ceased making their payments in October of 1982, filed a petition for reorganization under Chapter 11 of the United States Bankruptcy Code. One Debtor, Dr. Johnson, stated the business to be reorganized as "general dentistry." The other Debtor, Elizabeth A. Johnson, had no apparent means of employment.

Seven months elapsed in which time the Creditors never received currently accruing payments on the aforementioned Promissory Note. During those seven months, the Debtors petitioned the Bankruptcy Court and received two four-month extensions of time in which to file their plan for reorganization. Concerned with the appearance that the Debtors did not have the ability to put their affairs in order through a plan for reorganization, the Creditors, Milton R. Righetti, et al. (Respondents herein), began investigating the Debtors' affairs. This investigation began in April of 1983 by an informal request to review the Debtors' monthly operating reports (which are to be filed in Eureka each and every month pursuant to the Bankruptcy Court's Local Rules Number 13 and 14.). Much to the Creditor's dismay, the investigation was forestalled in that the Debtors had not filed *any* monthly operating reports since November of 1982, the date their Petition was filed! Thereafter, on April 8,

1984, the Debtors simultaneously filed four monthly operating reports. The content of those reports so alarmed the Creditors, that they decided to request Relief From the Automatic Stay, pursuant to 11 U.S.C. Section 362, to foreclose upon their Deed of Trust.

The grounds asserted by the Creditors for Relief From the Automatic Stay included an allegation that "good cause exists to vacate the Automatic Stay." (Appellants Excerpts of Record, Item No. 02, Line 26, Ninth Circuit's Record on Appeal)

As the Debtors correctly asserted in their Opening Brief to the Ninth Circuit, the parties stipulated that the Debtors had equity in the property. (Appellant's Opening Brief, Page 5, Lines 17-20, Ninth Circuit Record on Appeal). Thus, the sole issue for resolution by the Bankruptcy Court was whether or not the Creditors should be granted Relief From the Automatic Stay "for cause" pursuant to 11 U.S.C. Section 362(d)(1). The Bankruptcy Court, acting within its discretion, denied the Creditors' Request for Relief From the Automatic Stay. However, the Bankruptcy Court further awarded Debtors their attorney's fees incurred in opposing the Creditors' Request for Relief From the Automatic Stay, pursuant to California Civil Code Section 1717 (see Appendix, Order Denying Relief From Automatic Stay, filed August 30, 1983). The Creditors filed a timely appeal of the Bankruptcy Court's Order for Judgment in the United States District Court.

The United States District Court found that while the Bankruptcy Court's decision to deny Relief From the Automatic Stay was within its discretion, an award of attorney's fees in the action was erroneous (see Appendix, Order Affirming in Part and Reversing in Part the Order of the Bankruptcy Court, filed February 16, 1974). The U.S. Court of Appeals for the Ninth Circuit affirmed the District Court's decision and this appeal followed.

REASONS FOR DENYING THE WRIT

I. THE APPELLATE COURT'S DECISION IS CORRECT SINCE FEDERAL LAW PREEMPTS STATE LAW UNDER THESE CIRCUMSTANCES, THUS MAKING CALIFORNIA CIVIL CODE SECTION 1717 INAPPLICABLE

Although the issues raised in this Appeal appear to be novel, the law governing this area is virtually cast in stone. The Debtors are complicating the issues in this Appeal by taking various rules of law and applying them as precedent in this case without regard to the facts underlying the prior decisions. This method of bootstrapping from the facts to the conclusion misses the crucial analysis of the issues and facts upon which this Court should base its decision.

The critical issue to be resolved in this Appeal is whether a federal court can apply state substantive law (California Civil Code Section 1717) awarding attorney's fees after deciding a case pursuant to federal substantive law (11 U.S.C. Section 362(d)). Case law suggests that the United States Bankruptcy Courts have authority to apply either state substantive law or federal substantive law, the choice being dependent on the nature of the action presented to the Court.

For instance, the Ninth Circuit Court case of *In re Eastman*, 713 F.2d 443 (1983), decided just two years ago, applied California state law, apparently by concession of the parties, to decide whether two brokers had an enforceable commission agreement with the Debtors. This was obviously a state law issue, the only reason for a decision by the Bankruptcy Court being the Debtors' choice to file bankruptcy which placed the parties under the jurisdiction of the Bankruptcy Court. Thus, consistent with *In re Sparkman*, 703 F.2d 1097, 1100 (9th Cir. 1983), the Court applied California Civil Code Section 1717 and allowed the prevailing party its attorney's fees.

In re Sparkman, *id.*, at 1099, provides a lucid discussion on circumstances in which a federal court should

apply California Civil Code Section 1717. This case reasoned that a "federal court should apply state law not merely in determining whether a breach of contract occurred, but also in deciding whether to award attorney's fees on the claims" (*Id.* at 1099). Further authority and discussion supporting this position is found in *In re Sonoma*, 23 B.R. 789, 796 (Bkrcy. 9th Cir. 1982); *Klopfenstein v. Pargeter*, 597 F.2d 150, 152 (9th Cir. 1978); and *Matter of Comstock*, 16 B.R. 206 (Bkrcy. D. Idaho 1981). These cases all applied state substantive law *throughout the trial*, as the issues to be decided were clear state issues.

However, in a case such as the one at bar, where the action is predicated exclusively upon a federal statute [11 U.S.C. Section 362(d)], application of state law will not conform to established choice of law principles. For an analysis of which forum's law should be applied under these circumstances, one need not go further than a basic hornbook. Shepard's Manual of Federal Practice 2d. pg. 23 (1967) states in relevant part:

> "Of course, where the legal issue before the Court is a matter of federal law, *such as the interpretation of a federal statute*, the District Court applies *federal law* regardless of the state in which it sits. State courts, where they have jurisdiction of cases involving federal issues, must do the same. Thus, there is *uniformity* in the applicable rules of federal substantive law. Consequently, where federal substantive law governs, the only reason to go to one court rather than another is that federal courts, generally speaking, make a more informed application of federal law (emphasis added)."

Thus, the Creditors' position that *federal law* should govern a disposition of the Relief From Stay action to their benefit and then *state law* should govern a disposition of the attorney's fees issue to their benefit appears untenable.

The United States Bankruptcy Code is an all encompassing exercise of power by Congress. Once Congress

speaks on a particular issue, whether in the context of the entire United States Bankruptcy Code, or in the context of attorney's fees within the code [11 U.S.C. 506(b)] the Courts should not be at liberty to engage in judicial legislation either restricting or expanding the congressional mandate.

The eminent Justice Frankfurter, speaking for the United States Supreme Court in *Palmer v. Massachusetts*, 300 U.S. 79, 83 (1939), addressed this problem and reached a similar conclusion.

> "And so we have one of those problems in the reading of a statute wherein meaning is sought to be derived not from specific language but by fashioning a mosaic of significance out of the innuendoes of disjointed bits of a statute. At best this is subtle business, calling for great wariness lest what professes to be mere rendering becomes creation and attempted interpretation of legislation becomes legislation itself. Especially is wariness enjoined when the problem of construction implicates one of the recurring phases of our federalism and involves striking a balance between national and state authority in one of the most sensitive areas of government."

Petitioner's argument that 11 U.S.C. Section 506(b) should be expanded by this Court to include reciprocal compensation for attorney's fees incurred in defending requests for Relief From the Automatic Stay is patently inconsistent with the *Palmer* opinion. The Debtors' argument is without precedent and would constitute a state law intrusion into the federal arena which should not be sanctioned by this Court.

Further recent authority in support of Respondents' position is found in *Sanabria v. International Longshoremen's Association Local 1575*, 597 F.2d 312 (1979). The *Sanabria* case involved similar issues as the case at bar except the action was in Federal court due to the Labor Management Relations Act rather than due to the United States Bankruptcy Code. The court held that state law

awarding attorney's fees would not control the outcome where the Act did not provide for such coverage. Id.

II. ALTHOUGH THE PETITIONERS ASSERT AN ARGUMENT THAT THE CREDITORS HAD VIRTUALLY NO CHANCE FOR SUCCESS IN THEIR REQUEST FOR RELIEF FROM THE AUTOMATIC STAY, THE FACTS AND LAW SUGGEST OTHERWISE

The Creditors' Request for Relief From the Automatic Stay was predicated essentially upon an interpretation of 11 U.S.C. Section 362(d)(1). That particular part of the Bankruptcy Code States: ". . . the Court shall grant Relief from the Stay provided under Sub-Section A of this section . . .

1. *For cause,* including the lack of adequate protection of an interest in property of such party in interest; "[emphasis added, 11 U.S.C. Section 362(d)(1)]."

The cases which have interpreted Section 362 have employed a common theme in granting relief by recognizing a need for fairness and justice toward creditors who have had the Automatic Stay used as a sword against them while the debtor ignores the obligations and responsibilities imposed upon him under the Bankruptcy Code [see *In re Hinckle,* 14 B.R. 202 (1981); *In re Galbraith,* 19 B.R. 563, 565 (1982); *In re Wilson,* 30 B.R. 371 (1983)].

A notion of what the legislators had in mind while drafting Section 362 is discernible from the legislative history which states that "the facts of each request will determine whether relief is appropriate under the circumstances." H.R. Rep. No. 95-595, 95th Cong., 1st Sess. (1977).

Prior to the Creditors' Request for Relief From the Automatic Stay, the Debtors had not only withheld post-petition payments on the Creditors' Deed of Trust, but

also had flagrantly violated numerous provisions of the Bankruptcy Code as a debtor-in-possession. For purposes of brevity and clarity, the Debtors' violations of the Bankruptcy Code will be organized numerically:

1. Numerous violations of 11 U.S.C. Section 330-331 relating to compensation of officers and professional people only after "notice and a hearing."

a. "Legal and Accounting Services" . . . $1,394 (December, 1982, Monthly Operating Report, see Page 3);

b. "Legal and Accounting" . . . $2,524.00 (January, 1983, Monthly Operating Report, see Page 3);

c. "Professional Fees" . . . $92.00 (March, 1983, Monthly Operating Report, see Page 3);

d. "Accounting Services" . . . $1,000.00 (November, 1982, Monthly Operating Report, see Page 3).

Creditors in this case had *never* been notified of these payments as required by the Bankruptcy Code. This denies Creditors an opportunity to object to possible fraudulent payments and serve as important "overseers" in the case.

2. Further violations of Bankruptcy Rule 2002, which requires a twenty (20) day notice to Creditors before any sale of estate property not within Debtors' "ordinary course of business" (in this case "General Dentistry"); and before "any compensation or reimbursement of expenses totaling in excess of $100.00".

a. "Living Expenses" . . . $1,700.00 (November, 1982, Monthly Operating Report, see Page 4);

b. "Withdrawal from Dental Practice" . . . $9,500.00 (*ID*, at Page 4);

c. "Personal Expenditure" . . . $2,503.00 (December, 1982, Monthly Operating Report, see Page 3);

d. "Personal Expenditure" . . . $3,700.00 (January, 1982, Monthly Operating Report, see Page 3);

e. "Withdrawal from Dentistry" . . . $13,250.00 (January, 1983, Monthly Operating Report, see Page 4);

f. "Loan to J. D. Lumber" . . . $40,000.00 (February, 1983, Monthly Operating Report, see Page 4);

g. "Personal Expenditure" . . . $2,223.00 (March, 1983, Monthly Operating Report, see Page 3);

h. "Withdrawal from Dental Practice" . . . $13,000.00 (March, 1983, Monthly Operating Report, see Page 4);

i. "Cow Sales" . . . $478.00 (April, 1983, Monthly Operating Report, see Page 3).

To sift through these Operating Reports and provide this Court with each and every violation becomes tedious since the Reports are rife with violations and improper conduct. The purpose of the aforementioned provisions is to serve as a deterrent from Debtors siphoning estate assets into the hands of third parties.

Thus, a constant underlying theme in Petitioner's argument asserts a position which is both misleading and untrue. That theme asserts a quasifrivolous allegation. The Creditors' Request for Relief From the Automatic Stay was based on the "for cause" aspect of 11 U.S.C. Section 362(d)(1) over the "equity" aspect of Section 362(d)(1) and, although the trial court's decision was discretionary, there were sufficient facts from the Monthly Operating Reports to justify the Relief From the Automatic Stay should the Court have been inclined to rule in that direction.

III. THE "AMERICAN RULE", ALLOWING ATTORNEY'S FEES TO THE PREVAILING PARTY PURSUANT TO CONTRACT, IS INAPPLICABLE WHERE THE LITIGATION IS NEITHER A DIVERSITY ACTION NOR ON THE CONTRACT

Petitioner's argument correctly cites the *basic* "American Rule" on attorney's fees (Petition for Writ of Certiorari, Pgs. 7 and 8). The argument, however, fails to

recognize that this action was not predicated upon the underlying written contract. The issues in this case related *only* to whether 11 U.S.C. Section 362(d)(1) would allow the creditors relief from the Automatic Stay. There was no litigation concerning any of the contractual provisions.

An analysis of cases which Petitioner relies upon indicates that the enforcement of attorney's fees provisions are found in actions on the contract and based upon diversity jurisdiction. Authority to support Respondent's theory, indicates that "in an *ordinary diversity case*, where the state law does not run counter to a valid federal statute or rule court, and usually it will not, state law denying the right to attorney's fees, or giving a right thereto, which reflects a substantial policy of the state should be followed." Moore's Federal Practice, Section 54.77(2), pg. 1712 (emphasis added). This proposition suggests that where the case is *not* based upon diversity jurisdiction, federal law should control and since the Bankruptcy Code does not provide for attorney's fees under these circumstances, Petitioner's argument should fail.

CONCLUSION

For these reasons, a writ of certiorari should not issue to review the judgment and opinion of the Ninth Circuit.

Respectfully submitted,

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